

1 **FOR PUBLICATION**

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8 UNITED STATES BANKRUPTCY COURT
9 SOUTHERN DISTRICT OF CALIFORNIA

10 In re:) CASE NO. 02-06930-B13
11)
11 LAURA FREDRIKA PLUMA,) MEMORANDUM DECISION
12)
12 Debtor.)
13 _____)

14 At issue is the rate of interest that will provide the
15 County of San Diego ("County") with payments having a present
16 value equal to the allowed amount of its claim as required by
17 11 U.S.C. § 1325(a)(5)(B)(ii).

18 This Court has jurisdiction to determine this matter
19 pursuant to 28 U.S.C. §§ 1334 and 157(b)(1) and General Order
20 No. 312-D of the United States District Court for the Southern
21 District of California. This is a core proceeding pursuant to
22 28 U.S.C. § 157(b)(2)(B) and (L).

23
24 FACTS

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26 Laura Fredrika Pluma ("Debtor") filed her chapter 13
27 petition on July 16, 2002.¹ At the time of filing, Debtor was

28 _____
¹ This is the second time in the last two years that Debtor has filed
for protection under Chapter 13.

1 delinquent on her real property taxes (the "Taxes") in the
2 amount of \$1,932.03, including statutory penalties and interest.
3 The Taxes are secured by a lien on Debtor's real property
4 ("Property") pursuant to California Revenue & Taxation Code
5 § 2192.1. Debtor's plan provides for monthly payments to the
6 County at the rate of \$59 per month, with interest computed at
7 4.3% per annum.

8 Debtor alleges the fair market value of her Property is
9 \$260,000. In addition to the Taxes, Debtor owes Fairbanks
10 Corporation the sum of \$179,903, and another creditor \$3,000,
11 both of whom hold secured interests in the Property with a first
12 and second trust deed respectively.

13 Debtor's Statement of Income & Expenses indicates that her
14 net monthly income is \$1,901.97. She also receives supplemental
15 contributions to her income from her 21 year old son and 68 year
16 old father in the amounts of \$465 and \$1,000 per month
17 respectively. Debtor lists her expenses at \$2,927.40 per month,
18 leaving Debtor approximately \$440 per month in disposable income
19 to fund her plan. The term of the plan is approximately 38
20 months.

21 22 DISCUSSION

23
24 This case is a sequel to In re Williams, 273 B.R. 834
25 (Bankr. S.D. Cal. 2002). Unlike Williams, County concedes in this
26 case that the interest rate should be based on a market rate of
27 interest, rather than the 18% statutory rate set forth in
28 California Revenue & Taxation Code § 4103.

1 A. DETERMINATION OF INTEREST RATE

2 Section 1325(a)(5)(b)(i)(ii) provides in pertinent part:

3 (a) except as provided in subsection (b), the
4 court shall confirm a plan if-

5 * * *

6 (5) with respect to each allowed secured
7 claim provided for by the plan-

8 * * *

9 (B)(i) the plan provides that the holder of
10 such claim retain the lien securing such
11 claim; and

12 (ii) the value, as of the effective date of
13 the plan, of property to be distributed under
14 the plan on account of such claim is not less
15 than the allowed amount of such claim.

16 11 U.S.C. § 1325(a).

17 Debtor contends the appropriate rate of interest in this
18 case is 4.3%; County contends it should be 10%.

19 B. THE MARKET APPROACH

20 The Ninth Circuit has endorsed the market rate approach in
21 determining the cramdown interest rate. In re Fowler, 903 F.2d
22 694, 697 (9th Cir. 1990). The market rate approach is applicable
23 to deferred tax payments owed to governmental entities. In re
24 Camino Real Landscape Maint. Contractors, 818 F.2d 1503 (9th Cir.
25 1987).

26 1. Methods of Determining a Market Rate

27 "Cases differ drastically in their interpretation of how a
28 'market' rate is to be determined." Fowler, 903 F.3d at 697. One
approach requires the court to determine the current market
interest rate for similar loans in the region (the "similar loan

1 approach"). "Under this approach, the court sets the cramdown
2 rate by taking testimony on current market rates regarding loans
3 for the length of time involved secured by the type of property
4 involved." Id.

5 Another approach is the formula approach. Under this
6 approach, "the court starts with a base rate, either the prime
7 rate or the rate on treasury obligations, and adds a factor based
8 on the risk of default and the nature of the security (the "risk
9 factor")."² Id.

10 Debtor's expert uses the formula approach, while County's
11 expert urges the Court to adopt the similar loan approach.

12 2. Debtor's Expert Uses Formula Approach

13 Debtor's expert, George Dell ("Dell"), utilized the formula
14 approach in arriving at his market rate. As a base rate, Dell
15 chose the prime interest rate which was 4.25% at the time of the
16 hearing in this matter.³ Dell testified that an interest rate is
17 composed of three components: (a) the risk free rate, (b) the
18 expectation of inflation in the market; and (c) the risk of loss.

22 ² The risk of default is only one aspect of the "risk factor." The
23 nature of the security must also be taken into account.

24 ³ The prime interest rate is higher than the rate on treasury
25 obligations, which is the government's cost of borrowing. The court in Camino
26 Real noted that "this rate is usually quite low because to the lender the
27 government's obligation is a short-term, low risk investment. The obligation
28 of a private borrower is quite different; its creditworthiness is not the same
as the federal government's." The court further noted that the treasury rates
may be relevant, but not the same as the § 1129(a)(9)(C) rate. In re Camino
Real Landscape Maint. Contractors, 818 F.2d 1503, 1506 (9th Cir. 1987).

1 According to Dell, the prime interest rate⁴ forms a good market
2 approximation of the sum of "(a)" and "(b)." Dell opined that
3 component "(c)", the risk of loss, on an individual residential
4 property must be calculated from the potential loss of the entire
5 property and is different from the sum of "(a)" and "(b)".

6 Dell focused on the "risk factor" to the County. Dell
7 noted, and the parties concede, that Taxes owed to the County are
8 treated specially pursuant to California's statutory scheme. The
9 County has a first priority lien and is paid before every other
10 creditor, including consensual lienholders. Dell then took into
11 account that the arrears owed to the County are \$1,932.03 and
12 that the market value of the Property is \$260,000. He concluded
13 given the loan to value ratio, the Property would need to become
14 near worthless before the County experienced a loss. Dell stated
15 that either severe hazardous contamination or homes being washed
16 into the ocean are examples where a residential property could
17 lose its total value. He opined that total loss of value to a
18 residential property will only occur in rare cases. Thus, Dell
19 calculated the risk of total loss to the County at .01%.

20 Adding the prime interest rate to the risk factor, Dell
21 concluded that the appropriate market interest rate in this case
22 was 4.26%.

23 On cross-examination, Dell conceded that his analysis
24 regarding the appropriate interest rate was based on the
25 attributes of the collateral and not the Debtor. He conceded

26
27 ⁴ The Court agrees that the prime rate is appropriate to use as a base
28 rate in the formula approach. The prime rate is a readily available figure
and is easy to compute. Therefore, its use should minimize the need for
litigation and expert testimony.

1 that he had not reviewed Debtor's bankruptcy schedules and
2 statement of financial affairs and was unaware that Debtor had
3 filed a prior chapter 13 in June 2000. Dell testified that he
4 did not consider this information relevant to his analysis.
5 [Transcript dated December 13, 2002, 8:1-2; 13:9-12].
6 Accordingly, Dell did not consider the risk of default in his
7 analysis.

8 3. County's Expert Uses the Similar Loan Approach

9 In contrast, County's expert, Robert A. Taylor ("Taylor"),
10 based the County's interest rate on similar loans in the region.
11 Taylor affirmed that Taxes have a first priority position on
12 Debtor's Property, but collection of the Taxes could only be
13 enforced by the actual sale of the Property. Taylor testified
14 that a sale could be achieved by way of public auction which may
15 only occur five years after the tax has first become delinquent.
16 In other words, the County must wait six years after the tax is
17 first accrued to collect on the obligation. Taylor therefore
18 concluded that the obligation to County most closely compares to
19 a loan for a term of six years secured by a first deed of trust
20 against the primary residence of the borrower.

21 He conceded that the loan to value ratio in this case is
22 less than .01%. Taylor also opined that the Debtor is a sub-
23 prime borrower.

24 Taylor testified that during the period from November 13-19,
25 2002, the annual percentage rate charged on a thirty year fixed
26 loan secured by a first trust deed averaged approximately 5.85%.
27 However, the rates and fees which he obtained in his analysis
28 were quoted on a \$150,000 loan with an 80% loan to value ratio

1 offered to consumers with good credit characteristics. According
2 to Taylor, if these loans were adjusted to provide for
3 amortization over a five year time period, then the annual
4 percentage rate increases to approximately 9.4%. [Taylor Decl. ¶
5 11].

6 Additionally, Taylor's office conducted a telephone survey
7 of thirteen lending institutions in San Diego to determine
8 whether an individual with the Debtor's credit characteristics
9 would be able to obtain a loan secured by a first trust deed. Of
10 the institutions surveyed, only two indicated they would consider
11 such a loan, and the decision to do so would be based on the
12 specific circumstances of the borrower. Only one institution,
13 Southwest Bank, provided a rate of 10%, excluding fees and costs
14 for a five year loan. [Taylor Decl. ¶ 14].

15 Taylor testified that considering the secured position of
16 the County relative to the alleged value of the Property, his
17 research indicated that it would be very difficult for Debtor to
18 obtain a loan because of 1) the uncertainty of the Debtor's
19 ability to make the required payments; 2) the *small amount of the*
20 *loan*; and 3) the recent Chapter 13 bankruptcy (emphasis added).
21 [Taylor Decl. ¶ 16].

22 Taylor concluded that the market interest rate to the County
23 should not be less than 10% for several reasons. First, Debtor's
24 poor credit condition. Next, Taylor opined that there was a
25 substantial risk of default since Debtor relied on her father and
26 son to help meet her monthly obligations. Lastly, Taylor
27 considered current market interest rates available to borrowers
28 with good credit and reasonable collateral.

1 C. THE COURT CONCLUDES THAT IN THIS CHAPTER 13 CASE THE
2 FORMULA APPROACH IS MORE ACCURATE

3 After considering the testimony, cross-examination, and
4 argument from both parties, the Court concludes that the formula
5 approach is the better of the two methods for determining a
6 market rate of interest in cramdown situations such as this.⁵
7 The approach urged upon by County is unnecessarily unwieldy and
8 arbitrary because it examines market rates in a hypothetical
9 market.

10 Taylor's testimony demonstrated how difficult it is to
11 arrive at an appropriate interest rate using the current market
12 interest rate for similar loans in the region. The 5.85% annual
13 percentage rate that Taylor started his analysis with was based
14 on annual percentage rates charged on thirty year fixed mortgages
15 secured by a first trust deed. The rates and fees were quoted on
16 an \$150,000 loan with an 80% loan to value ratio. Taylor's
17 testimony regarding his telephone survey also revealed that very
18 few lenders would be willing to make a loan to a borrower with
19 Debtor's characteristics.

20 County relies heavily on Fowler, 903 F.2d at 692. In
21 Fowler, a Chapter 12 debtor was attempting to cramdown a loan
22 owed to the Farm Credit Bank in the amount of \$159,000 on two
23 thirty-five year variable rate promissory notes and a loan owed
24 to Production Credit Association in the amount of \$22,000 on a
25

26 ⁵ The use of a formula should only be a presumption, and the courts
27 should always allow the parties to introduce evidence of market rates to rebut
28 the presumption. Fowler, 903 F.2d at 698 (citations omitted). The Court has
allowed the County to introduce evidence of market rates to rebut the
presumption.

1 one year note. There was ample evidence before the Fowler court
2 regarding the current market rates for loans at the length of
3 time involved on farm property in Montana.

4 In contrast, Debtor's obligation to County has unique
5 aspects that make comparisons to similar loans in the region
6 difficult. Debtor's obligation to County for her Taxes involves
7 a small amount and will be paid in a relatively short time. The
8 small amount and short time period involved does not typically
9 arise in the market examined by Taylor.⁶ Finally, although few
10 lenders would lend to borrowers with the characteristics of
11 Debtor, in reality the risk of default, one aspect of the "risk
12 factor" is de minimis given the chapter 13 process.

13 This Court noted in Williams, 273 B.R. 834, the "risk of
14 default" is minimized in a chapter 13 case, given the protections
15 that creditors enjoy under chapter 13 of the Bankruptcy Code.
16 Id. at 838 (citations omitted). Specifically, chapter 13 debtors
17 must show that they are financially able to make all their
18 payments under the proposed plan. Also, creditors have an
19 enhanced ability to access the debtor's ability to service their
20 debt, and wage orders can be used in Chapter 13's, to eliminate
21 the risk of debtors defaulting on their monthly plan payments.
22 Finally, the cost of collection is eliminated in a chapter 13
23 proceeding and the costs of administration are largely borne by
24 the chapter 13 trustee.

25 Even though Fowler relied heavily on the similar loan
26

27 ⁶ See In re Villa Diablo Assocs., 156 B.R. 650, 655 (Bankr. N.D. Cal.
28 1993)("There is...no market which can quote terms for...the 'cram down' loans
Congress provided for in [c]hapters 11, 12 and 13 of the Bankruptcy Code").

1 approach, the court's risk of default analysis can be applied
2 when using the formula approach. The Ninth Circuit in Fowler
3 noted that in assessing the "risk of default", the risk is
4 reduced to some extent in Chapter 12 plans because the trustee
5 oversees the affairs of the debtor and the administrative and
6 collection costs are lower. Fowler, 903 F.2d 697. The Circuit
7 also noted that confirmation of the Chapter 12 plan implies that
8 the debtors have convinced the bankruptcy judge that the plan is
9 feasible and the fact that the plan overcame such a hurdle
10 heightens the probability of repayment. Id. Even though Fowler
11 involved a Chapter 12 plan, the test for confirmation of Chapter
12 12 and 13 plans is almost identical.

13 As of the date of this hearing, Debtor was current on her
14 payments to the chapter 13 trustee. Debtor's plan proposes to
15 pay the County in full in approximately thirty-six months and she
16 has already made payments since July 16, 2002. Taylor testified
17 that the County must wait six years after the tax is first
18 accrued to collect on the obligation by holding a public auction.
19 Yet, Debtor proposes to pay the County in full with interest well
20 before County would be entitled to hold the public auction. The
21 Ninth Circuit in Fowler noted that where the debt is long term,
22 there is a higher "risk of default." Id. at 698. In contrast,
23 the risk of default would be lower in this case since Debtor will
24 pay County in a relatively short period of time.

25 Finally, Dell's testimony regarding the "risk factor"
26 remains undisputed. Unlike Taylor, Dell focused on the nature of
27 the security rather than the risk of default. The Court views
28 the two aspects of the risk factor -- the nature of the security

1 and the risk of default -- at two different ends of the spectrum
2 for purposes of the risk factor analysis. In the circumstances
3 of this case, because the risk of default is so slight, more
4 weight properly goes to analyzing the nature of the security
5 involved.

6 It happens, though, that in this case, the risk involved
7 with the County's secured position in the Property, is also
8 slight. The loan to value ratio is less than .01% and the
9 obligation to the County is secured by property valued at
10 \$260,000. As Dell testified, unless the residence has severe
11 hazardous materials contamination or literally falls off a cliff
12 or washes out into the ocean, the risk of loss to County is de
13 minimis.⁷ County also enjoys a priority status on the Property
14 and Dell testified there were no foreclosure costs involved.
15 [Transcript dated December 12, 2002, 15:24-25].

16 Accordingly, the Court concludes that the formula approach
17 lends itself to the unique aspects of a chapter 13 case where a
18 debtor's tax obligation is small relative to the value of the
19 property involved, and where the taxing authority has a statutory
20 right to a first priority position above all other lienholders.
21 Moreover, the Court concludes that an emphasis on the nature of
22 the security, rather than the risk of default, is appropriate in
23 a chapter 13 case when determining the "risk factor" under the

24
25
26 ⁷ County's counsel argued that under the analysis in Camino Real, 818
27 F.2d 1503, the attributes of the creditor are irrelevant to the analysis in
28 this case. This Court disagrees. Counsel's use of the phrase "attributes of
the creditor" is simply another way of saying "the nature of the security" or
the "risk factor" that the Ninth Circuit used in In re Fowler, 903 F.2d 694,
697.

1 formula approach. Thus, the 4.26% interest rate⁸ is the
2 suitable interest rate for this case.

3
4 CONCLUSION

5
6 The Court finds that the appropriate market rate of interest
7 is 4.26%.

8 This Memorandum Decision constitutes findings of fact and
9 conclusions of law pursuant to Federal Rule of Bankruptcy
10 Procedure 7052. The attorney for the Debtor is directed to file
11 with this Court an order in conformance with this Memorandum
12 Decision within ten (10) days from the date of entry thereof.

13
14 Dated: February 11, 2003

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John J. Hargrove
United States Bankruptcy Judge

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⁸ Debtor agreed to pay 4.3% through her plan.
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